

Need Subcontractors?

How to Hire Like a Boss



Table Of Contents

Introduction..... 3

5 Benefits of Subcontracting for IT Businesses..... 6

Always Use Written Subcontractor Agreements 11

Always Request Proof of E&O Insurance 16

Sample Subcontracting Agreement Template..... 22

**Conclusion: Subcontractor Risk Management
Starts with Two Sheets of Paper..... 26**

Introduction

Subcontracting is a great way for IT businesses to save money and increase output. But more cooks in the kitchen means more room for mistakes and oversights. To prevent the costly problems that can crop up when you hire subcontractors, it's essential to do two things:

1. Use written contracts to define your relationship.
2. Require proof of [Errors and Omissions Insurance](#).

Why worry about subcontractor insurance? If your subcontractors don't have insurance, liability for anything that goes wrong with a project falls squarely on you. Ensuring your contractors have coverage is a way to protect your business from financial risk.



SUBCONTRACTORS ARE COMMON – AND RISKY

Each year, TechInsurance works with tens of thousands of IT professionals. That gives us a unique opportunity to gather data from small tech businesses and track trends in IT business liability.

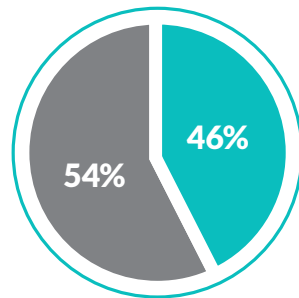
This year we looked at data from more than 10,000 technology professionals who applied for insurance and found that many IT professionals who use subcontractors are often not taking basic steps to protect their businesses. Specifically:

- Only **46 percent** use a formal contract or subcontracting agreement.
- Just over half (**57 percent**) require evidence of E&O Insurance from all subcontractors.

Subcontractors in Small Tech Businesses

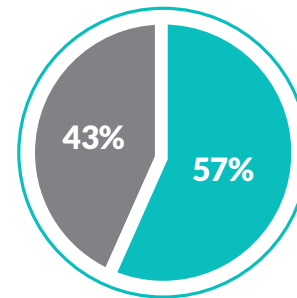
—
24% of TechInsurance customers use subcontractors to outsource 14 – 45% of their work, depending on their specialty.

Use of Formal Contracting Agreements



- Use a formal agreement
- Don't use a formal agreement

E&O Insurance Requirement from Subcontractors



- Require proof of insurance
- Don't require proof

It's not that hiring subcontractors is inherently risky. Subcontractors can deliver high-quality work and boost your productivity. But if you hire a subcontractor and you don't ensure that they have insurance coverage, you leave a gaping hole in your lawsuit protection. Their mistakes could trigger client lawsuits that name you. And if your subcontractors don't have their own insurance, you could be the one who ends up paying.

Brandyn Morelli (@BrandynMorelli), partner at Onyx (@onyxlosangeles), a design and development firm in Los Angeles, puts it this way: "Hiring subcontractors can be a valuable asset to a small business, or a straight nightmare." The payoffs are great, but you need to be prepared for the risks, too.

HOW TO USE THIS GUIDE

In the following pages, IT project managers can learn how to understand their relationship to subcontractors in terms of business risk and liability. We'll cover a wide range of topics, including...

- The benefits of subcontracting for IT businesses.
- Tips for creating strong written contracts and agreements.
- Steps for requesting proof of E&O Insurance.
- Sample subcontractor agreement templates.

5 Benefits of Subcontracting for IT Businesses



5 Benefits of Subcontracting for IT Businesses

Payroll services company SurePayroll found in 2013 that one in five small-business owners actually prefers subcontractors to regular employees. Why is that?



1. MONEY

Subcontractors cost less than employees and don't come with a long-term financial commitment.



2. TIME

IT business owners are swamped. Outsourcing work to subcontractors can free up their time to focus on big-picture problems.



3. FLEXIBILITY

Many businesses choose subcontractors for the flexibility they offer: without the commitment to long-term employment, businesses can easily increase and decrease capacity.



4. EXPERTISE

Subcontractors add tools to your toolbox. Whether you need help with SEO, SQL, or accounting, you can hire a subcontractor to make sure your team has all the skills it needs to handle a project.



5. SIMPLICITY

When you subcontract, you only have a fraction of the paperwork that comes with hiring a fulltime employee.

1 in 5 small-business owners prefers subcontractors to regular employees



Subcontracting offers five main benefits to small businesses:



1. MONEY

Because you don't have to pay benefits for contractors, they can cost significantly less than employees.

TechRepublic [estimates](#) that employee benefits run as much as 20 to 50 percent of salary. An employee making \$70,000 in salary could really cost their employer \$84,000 to \$105,000 when you factor in benefits, taxes, and things like [Workers' Compensation Insurance](#).

The flip side is that a contractor can cost you less. When you factor in the cost savings that comes with not having to pay benefits, a contractor making \$80k is actually less expensive than an employee making \$70k.



2. TIME

Small-business owners are used to doing everything themselves. At a certain point, your business will take on projects that make this impossible. When that happens, you can hire subcontractors to help you get work done faster.

Because subcontractors work project by project, they often have a strong incentive to finish a project quickly and well, so they can move on to other jobs. Short-term, project-based employment can spur your subcontractors to work better.

A Harvard Business Review [article](#) shows how DARPA, the research organization that invented the Internet, uses temporary project teams to improve productivity. This approach keeps your team focused on the task at hand and motivates them to finish faster.

Plus, there's the added benefit of being able to hire people to work during your off hours. James Johnson, managing partner at [SnowPak \(@BestSkiPackages\)](#), an ecommerce site that sells ski travel packages, points out that "working with people in different time zones can be great. We can send off work in the afternoon and have it finished when we wake up the next day. Research projects are fantastic for outsourcing."



3. FLEXIBILITY

Say you run a small software development firm. On any given day, a client could walk through your doors with a project that pays well but requires more resources than you currently have. This is exactly where subcontractors can help.

By hiring additional developers as subcontractors, you can handle the extra workload. You can scale your staff up or down depending on project capacity – the definition of flexibility.

Johnson has found this especially helpful as a small-business owner. "A small business doesn't need a full-time social media manager, but having one for 10 hours a week can make a huge difference, and really frees us up to manage the more important tasks," he says.



4. EXPERTISE

This might be the most “no-brainer” reason to hire subcontractors: you need their expertise.

You may need contractors to help you with accounting, HR, or other nuts and bolts of running a business. Or you may need their IT expertise. Bringing in statisticians, UX experts, or security consultants can improve the product you deliver to clients.

And sometimes you might go to subcontractors for their "soft" skills and marketing acumen. Mitch Goldstone, CEO of [ScanMyPhotos.com \(@ScanMyPhotos\)](#), explains that "most tech companies are, well, techie."

Common Tasks IT Businesses Subcontract

- >> Accounting
- >> Graphic design
- >> Web development
- >> Marketing
- >> HR

Goldstone's team was great at coding and setting up an ecommerce website – which has digitized over 300 million photos – but they weren't exactly great at writing product descriptions, blog posts, and catchy marketing materials. For that, they turned to contractors.

Whatever skills you're looking to add, contractors can help you get the job done.



5. SIMPLICITY

The paperwork involved in hiring a contractor is much simpler than what's required to hire an employee. Because you generally don't have to cover payroll taxes, unemployment insurance, or social security, hiring a subcontractor is easier. All you need is a subcontractor's agreement.

That said: you may be responsible for making sure subcontractors have **Workers' Compensation Insurance**. You don't necessarily have to buy their coverage; just check to make sure they've got it.

Why do you have to check for Workers' Comp? While you generally don't owe benefits to subcontractors, there are two cases where you might have to ensure that they're covered:

- 1. A client contract requires you to have Workers' Comp.** As the managing contractor, it becomes your responsibility to make sure subcontractors have this coverage.
- 2. State law requires it.** Most states don't require you to have coverage for subcontractors, but some might.

If you face either of these situations, you can require subcontractors to carry their own Workers' Comp. Make sure to outline these requirements in your subcontracting agreement.

Always Use Written Subcontractor Agreements



Always Use Written Subcontractor Agreements

Subcontractors are a great way to boost your business's productivity without having to pay the high costs that come with employees – but what risks come with hiring subcontractors?

The Court Statistics Project *estimates* that a dispute over a contract typically costs a whopping \$91,000 when all is said and done. Raise your hand if you've got that kind of money lying around. No? Didn't think so.

Many IT business owners have a gaping hole in their contract risk management. Our research shows that **54 percent** of IT businesses don't use a formal contract when they hire a subcontractor.

It's optimistic of small-business owners to think they won't ever run into contract problems. According to a *study* by the International Association for Contract & Commercial Management, **nine percent** of contracts result in a significant dispute or claim.

From a risk management perspective, going without a subcontractor's agreement is like smoking a cigarette while you're pumping gas. Not super savvy.



More than half of IT businesses hire subcontractors without a written agreement.



**In contracts,
include language
that clarifies
whether someone
is a contractor or
an employee.**



SUBCONTRACTOR AGREEMENTS: REDUCING YOUR RISK

Without a subcontractor agreement, your risk for an expensive dispute increases. This prompts the question: why are contracts so important?

Sally A. Piefer, attorney with the [Schroeder Group \(@tsglaw1\)](#), explains:

- The scope of a project.
- Payment.
- Important terms and conditions.

“I generally take the opportunity to include self-serving language in the agreement which makes it expressly clear that the individual is an independent contractor and not an employee, and to include indemnification language in the event the contractor is deemed to be an employee,” Piefer says.

Lance Vaughn (@[lance_io](#)), CEO of web and mobile app company [CabForward \(@CabForward\)](#), has run into problems with flaky contractors who overpromised and delivered underwhelming results.

Vaughn had one contractor who said he could work, but Vaughn soon discovered that the contractor was already committed to 80 hours of work with other companies. Suddenly, CabForward had to work around its contractor’s busy schedule. That’s not the way things are supposed to happen.

Having a strong, clear contract that outlines your expectations for the subcontractor helps you avoid these mishaps.

5 WAYS SUBCONTRACTOR AGREEMENTS PROTECT YOUR BUSINESS

You can add language to your contracts to provide additional protection from certain liabilities.

A subcontracting agreement may protect you by:

- 1. Ensuring all parties carry liability insurance.** Just as there's a food chain, there's a chain of liability. If a contractor messes up part of a project, you're the one who could feel the heat in a client lawsuit. By ensuring that contractors have liability insurance, you can pass on the financial burden of a lawsuit.
- 2. Preventing missed deadlines or incomplete work.** Subcontractors could bail on a project for many reasons. Outsourcing work can be smart, but it means you're at someone else's mercy. Contracts formalize your relationship and can make it less likely for a contractor to leave you hanging.
- 3. Assigning data liabilities.** Contracts can specify how you want subcontractors to handle client data. Contracts should specify whether subcontractors are supposed to delete old data, remove their access to it, or store it securely. In the age of cyber liability, your clients expect you to take these steps to safeguard their data.
- 4. Specifying insurance requirements.** Subcontractor contracts are an easy way to specify your **E&O Insurance** requirements. Subcontractors will know they need insurance *before* they sign on the dotted line. You can require them to attach a copy of their **Certificate of Liability Insurance** to the contract itself.
- 5. Clarifying complicated IT projects.** Project management educational resource Project Smart's 2014 **Chaos Report** [PDF] found that only **61 percent** of software projects are delivered with the originally specified features. Scope and software features can be incredibly hard to pin down. Trying to get that done without a contract? Good luck. Consulting contracts make sure you're on the same page as subcontractors.

By the Numbers

9%

of contracts result in disputes



54%

of businesses don't use a subcontracting agreement



\$91,000

Average cost of a contract dispute

Complication has scuttled many an IT project. While running SnowPak, managing partner James Johnson has found that, to be successful with subcontractors, he has to tell them exactly what to do. The clearer and simpler the project, the more likely it is to get done well and on time.

“The issues are usually around communication, so the more defined our problem is, the better the results usually [are],” Johnson says. “We have found it has been too hard to hire subcontractors for problems that need creative solutions or where the path forward isn't very clear.”

Of course, a subcontractor agreement doesn't mean you'll never get into a dispute with clients or contractors. But a strong, well-written contract can prevent misunderstandings that lead to lawsuits and minimize the damage if you are sued.

Use contractors when the problem is self-contained and clearly defined.



Always Request Proof of E&O Insurance



Always Request Proof of E&O Insurance

A Certificate of Liability Insurance is a single-page summary of the coverage provided by an insurance policy.



Okay, so hopefully you're sold on contracts. But they're not the only form of documentation you'll want when hiring subcontractors. You'll also want to make sure they're carrying [Professional Liability Insurance](#) (also sometimes called Errors & Omissions Insurance, or E&O).

Attorney Daniel Lieberman of [Devine Law Offices \(@DLOLancaster\)](#) puts it this way: "It is vital that subcontractors carry their own Professional Liability Insurance." As an employment lawyer for nearly 20 years, he knows it's crucial that business owners take steps to manage their liability.

E&O Insurance can help cover lawsuits when a subcontractor makes a mistake. When a client sues over a product you deliver, they'll likely name everyone involved in completing the product. If your subcontractor has their own insurance, their policy can cover their costs, which means your policy has less work to do. Remember: the average contract dispute costs \$91,000.

It's also worth noting, as Lieberman points out, that employers and subcontractors are often in a gray area when it comes to legal liability. It's essential that businesses consult with a lawyer about their use of subcontractors and contracts, and it's just as important to ensure that subcontractors have liability coverage.

WHAT YOU NEED TO KNOW ABOUT SUBCONTRACTORS' E&O INSURANCE

To confirm that your subcontractors actually have Errors and Omissions Insurance (and that it's the right amount of coverage to protect you), you'll need to check their [Certificate of Liability Insurance](#) [PDF].

What's an Insurance Certificate? It is a single-page document that summarizes the coverage a policy offers, including...

- Expiration date.
- Coverage limits.
- Exclusions.

Be sure to check insurance documentation each time you hire a subcontractor.

REQUESTING PROOF OF INSURANCE

Perhaps not surprisingly, the first step to requesting proof of insurance involves requiring it in your contracts. Matt Meyers, an attorney with [Becker Poliakoff \(@BeckerPoliakoff\)](#), jokes that he's one of the "nasty plaintiff lawyers," meaning he's the guy who sues you when someone messes up a contract. He knows better than most how to make sure your insurance ducks are all in a row.

To ensure subcontractors have the right insurance, Meyers recommends that your contracts have the following requirements:

- Subcontractors must show you proof of insurance (i.e., a [Certificate of Insurance](#)).
- The Certificate of Insurance must show that the policy is paid for and the coverage will be in effect while the contractor is working for you. (It's also wise to verify with the carrier that premiums have actually been paid.)
- The policy must have adequate coverage (for technology Errors & Omissions Insurance, that's typically around \$1 or \$2 million).
- Your business must be named as an additional insured on the policy.
- Subcontractors must agree to defend and indemnify your business, holding you harmless in the event of a lawsuit.

Clauses in your contracts may need to be worded carefully to reflect particular case law in your state.

WHEN TO REQUEST PROOF OF INSURANCE

Before hiring, notify subcontractors of any E&O Insurance requirements they need to meet to begin work. You may want to list these requirements in job postings to weed out any applicants who don't have coverage. During interviews and negotiations, ensure they know they'll need to show you an actual Certificate of Insurance (a digital copy is fine).

Why do you need to see the Certificate of Insurance? You can risk taking your contractor's word for it, but it's better to do your homework. Verify coverage by contacting the listed insurer to make sure the policy is active.



**Always check a
subcontractor's
Certificate of
Liability Insurance**

Verifying a contractor's insurance helps limit your liability.



WHY BOTHER REQUESTING PROOF OF INSURANCE?

Requesting proof of insurance lets you...

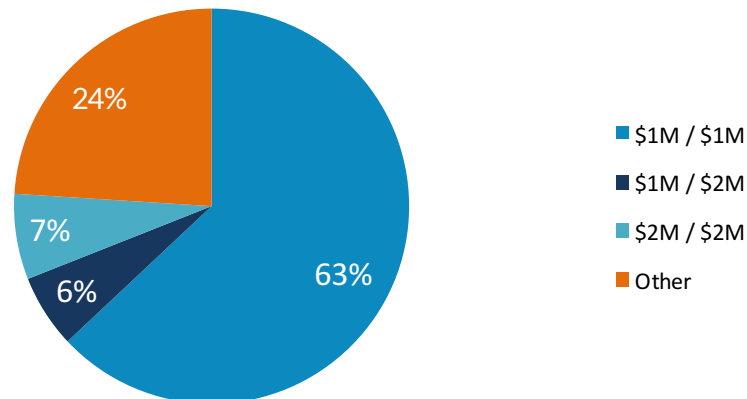
1. Verify that your subcontractors are financially stable and have taken steps to limit their liability.
2. Ensure that your insurance, claims history, and reputation won't take a hit if a subcontractor makes a mistake and the lawsuit falls on you.

Think of it this way: insurance works like a roof. If there's a leak anywhere, your house is at risk. Your coverage may be strong, but if a subcontractor doesn't have coverage, your business is exposed to financial risk.

HOW MUCH TECHNOLOGY ERRORS & OMISSIONS INSURANCE DO SUBCONTRACTORS NEED?

When you check a contractor's Insurance Certificate, you'll most likely see technology E&O Insurance that offers protection with a \$1 million or \$2 million limit. More than **75 percent** of our customers choose coverage in that range.

Common Errors and Omissions Insurance Limits



Policies have an aggregate limit and a per-incident limit (called an “occurrence” limit). The graphic on the previous page shows the three most common policies among small tech business:

- \$1 million occurrence and \$1 million aggregate coverage (63 percent).
- \$1 million / \$2 million (6 percent).
- \$2 million / \$2 million (7 percent).

Of course, your clients may request more coverage if you’re working on a big project. Naturally, before you tell your subcontractors how much coverage they’ll need, go back to the client contract and check its requirements.



Sample Subcontracting Agreement Template



Sample Subcontracting Agreement

We started this report with our finding that more than half of small IT businesses don't have formal subcontracting agreements. That data point suggests two things:

1. IT businesses have significant risk exposure through their subcontractors.
2. IT business owners may not be familiar with subcontracting agreements.

To help you on both fronts, we've provided a sample subcontracting contract as a starting point for your next hire, along with an explanation of how these agreements work. It's linked below as a Word document.



[Sample Subcontractor Agreement](#)

WHAT'S IN A SUBCONTRACTING AGREEMENT?

Our sample subcontractor contract outlines basic contract terms, including...

- Compensation.**
- Payment schedule.**
- Rights subcontractors give you to their work.**
- Which expenses, if any, the subcontractor may be reimbursed for.**
- Scope of work.**
- Rights to terminate the contract.**
- Requirements for **Technology Errors and Omissions Insurance**.**

The sample also includes the basic conditions you should impart to protect your business from unnecessary liability when you hire a subcontractor.

By defining these terms, you may avoid some of the miscommunications that can lead to lawsuits. Additionally, a good contract will offer warranties and indemnification, which clarify sticking points and theoretically limit what a subcontractor could sue your business for.



Consult with a lawyer to ensure your subcontractor agreements meet legal and industry standards.

HOW TO USE THIS SUBCONTRACTING AGREEMENT TEMPLATE

It's important to note that the subcontracting agreement linked above is a starting point, not a final product. Your business should always consult with a lawyer and build a custom contract when working with a new subcontractor.

WHY CUSTOMIZE CONTRACTS?

Contracts should be tailored to your project and the specific area of IT you work in. For example, if you work in healthcare IT, your subcontractors will need to follow HIPAA standards, and this expectation should be outlined in your contract.

If you work in web design, you'll want to ensure your contract gives you the rights to any creative content (e.g., logos, images, designs, etc.) a subcontractor develops for the project.

Next time you hire a subcontractor, start with this template, adapt it for your project, and ensure you're not among the 54 percent of IT businesses that go without subcontractor agreements.

Conclusion:

Subcontractor Risk Management Starts with Two Sheets of Paper



Subcontractor Risk Management Starts with Two Sheets of Paper

Hiring subcontractors is a cost-effective way for small IT businesses to take on new projects, streamline operations, and offer services they wouldn't otherwise be able to. It's also a surefire way to increase a business's exposure to mistakes, oversights, and lawsuits. Luckily, business owners can reduce their liability exposure by using written contracts for every subcontractor relationship and ensuring that all subcontractors carry Errors & Omissions Insurance.